

---

# CPI Competition Policy Institute

---

DOCKET FILE COPY ORIGINAL

August 19, 1997

Mr. William Caton  
Secretary  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, D.C. 20554

RECEIVED

AUG 19 1997

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

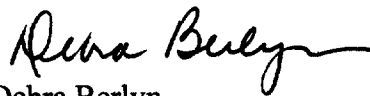
CC Dockets: No. 96-262, No. 94-1; No. 91-213; No. 95-72; No. 96-45

Dear Mr. Caton:

Pursuant to section 1.41 of the Federal Communications Commission's Rules, 47 U.S.C. §1.41, the Competition Policy Institute (CPI) respectfully asks the Federal Communications Commission to accept the attached version of CPI's comments on the petitions for reconsideration and clarification in the above-captioned proceedings one day after the date for comments of August 18, 1997. CPI experienced unforeseen administrative difficulties that interfered with its ability to reproduce the required copies prior to the close of the day. These difficulties made it impossible to file the document by the end of the day on Monday, August 18, 1997.

Please date stamp and return one copy of this filing to CPI. Thank you.

Sincerely,

  
Debra Berlyn  
Executive Director

No. of Copies rec'd \_\_\_\_\_  
List ABCDE \_\_\_\_\_

0410

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

**RECEIVED**

AUG 19 1997

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
End User Common Line Charges	)	CC Docket No. 95-72
	)	
<hr/>		
In the Matter of	)	
	)	
	)	
Federal-State Joint Board	)	CC Docket No. 96-45
on Universal Service	)	
	)	
<hr/>		

**PARTIAL SUPPORT AND PARTIAL OPPOSITION OF THE  
COMPETITION POLICY INSTITUTE  
  
TO THE  
  
PETITIONS FOR RECONSIDERATION AND CLARIFICATION**

Ronald Binz, President and Policy Director  
Debra Berlyn, Executive Director  
John Windhausen, Jr., General Counsel

Competition Policy Institute  
1156 15th St. N.W. Suite 310  
Washington, D.C. 20005  
Phone: (202) 835-0202  
Fax: (202) 835-1132

August 18, 1997

## SUMMARY

The Competition Policy Institute (CPI) supports in part the Petitions for Reconsideration filed by the small interexchange carriers and their trade associations. These petitioners have identified elements of the Commission's *Access Reform Order* that may have a strongly negative impact on such small carriers, especially if these carriers serve predominately business customers with relatively low long distance usage or if they serve consumers in rural areas. CPI agrees with the Petitioners that the Commission should reconsider three items in its *Access Reform Order*: 1) the application of the monthly Primary Interexchange Carrier Charge (PICC) of \$2.75 per line for multi-line business customers; 2) the elimination of the "unitary rate" tariff option for tandem-switched transport services; and 3) the substantial price increase in tandem switching services provided to these carriers.

If the Commission acts to reduce or phase in the PICC for multi-line business customers, it must make other modifications to the *Access Reform Order* to accommodate the reduction in revenue that will be caused by such a change in the PICC. CPI suggests that there are two options to account for the reduced revenues. First, the Commission could increase the per-minute access charge to account for the reduction in PICC revenue, as suggested by some of the petitioners. Second, the Commission could lower the overall level of access revenues paid to the LECs by adjusting the price cap formula or requiring a partial reinitialization of rates toward the Commission's benchmark rate of return. The Commission should examine both options, but should have a preference for a reduction of total access revenues collected by LECs.

CPI supports the Petition of AT&T for Partial Reconsideration of the *Access Reform Order* on the issues of the computation of the X-factor, the application of the revised X-factor to 1995 and the elimination of the "low end adjustment" in the Commission's access charge rules.

CPI opposes the request of USTA that the Commission reconsider the portion of its *Access Charge Order* that requires price cap LECs to reflect the revenues derived from the federal high cost fund in access rates. USTA has not shown that its recommendation is needed; the putative issue raised by USTA concerns state revenue requirements, not federal revenues; finally, the adjustment recommended by USTA could merely extend and exacerbate above-market returns of the price cap LECs.

CPI opposes the petitions that ask the Commission to reconsider its decision to exempt the prices of unbundled network elements (UNEs) from the application of access charges. The Commission would err if it reversed itself on this issue: fairness requires that purchasers of UNEs pay only once for the product; as a matter of competition policy, the Commission has made the correct decision on this issue.

CPI opposes the request of AT&T that the Commission require carriers to collect contributions to the Universal Service Fund through a monthly end user charge. It is appropriate that all telecommunications providers, including interexchange carriers, contribute to the cost of universal service. The exact manner in which these providers recollect the contribution from end users should be subjected to competition in the marketplace. The Commission was correct not to adopt increased end user charges to fund universal service.

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
End User Common Line Charges	)	CC Docket No. 95-72
	)	
<hr/>		
In the Matter of	)	
	)	
	)	
Federal-State Joint Board	)	CC Docket No. 96-45
on Universal Service	)	
	)	

**PARTIAL SUPPORT AND PARTIAL OPPOSITION OF THE  
COMPETITION POLICY INSTITUTE  
TO MOTIONS FOR RECONSIDERATION OR CLARIFICATION**

The Competition Policy Institute (CPI) respectfully submits its response to several Petitions for Reconsideration and Clarification filed in the above-captioned cases. CPI is an independent non-profit organization that advocates policies to bring competition to telecommunications and energy markets in ways that benefit consumers. We appreciate the opportunity to respond to several Petitions for Reconsideration filed by parties to these cases. Because of the numerous petitions, and because of the interlocking nature of these dockets, we have combined our partial support and our partial opposition to numerous petitions into this single response.

**I. The Commission Should Reconsider Elements of Its *Access Charge Order* That May Have a Disproportionate Effect on Small IXC's, Rural Consumers And Multi-line Businesses With Relatively Low Long Distance Use.**

In its First Report and Order in CC Docket No. 96-262 (*Access Reform Order*) released May 16, 1997, and its Second Report and Order in CC Docket No. 96-262 (*Price Cap Performance Review Order*), released May 21, 1997, the Commission made numerous and significant changes to the level and design of carrier access charges. CPI generally supported those changes to reduce the level of carrier access charges and to reform the manner in which the charges are collected, although CPI believes the Commission should have required larger access reductions.

Subsequent to the release of those orders, the Commission received numerous petitions for reconsideration of the *Access Reform Order* from small long distance companies and their trade associations.<sup>1</sup> Although these petitions vary in details and in the specific issues raised, collectively they make the point that the Commission's *Access Reform Order* has several features that, taken together, would severely disadvantage many small long distance companies and the customers they serve. Specifically, three portions of the Order were identified as having a "devastating"<sup>2</sup> effect on small IXC's: 1) the adoption of the \$2.75 Primary Interexchange Carrier

---

<sup>1</sup>See Petitions for Reconsideration filed by America's Carriers Telecommunications Association (ACTA), Competitive Telecommunications Association (CompTel), Excel Telecommunications, Inc. (Excel), Frontier Corporation (Frontier), KLP, Inc. d/b/a Call-America and Yavapai Telephone Exchange, Inc. (Call-America), RCN Telecom Services, Inc. (RCN), Telecommunications Resellers Association (TRA), U.S. Long Distance (USLD), and Worldcom, Inc. (Worldcom).

<sup>2</sup>Petition of TRA at iii.

Charge (PICC) on multi-line business customers; 2) repricing of tandem-switched transport service and the elimination of the "unitary" pricing option for that service; and 3) increased rates for tandem switching service.

In its petition, CompTel illustrated the effect that each of these changes would have on the access costs of various of its members. CompTel's analysis shows that the viability of some small resellers may be in jeopardy as a result of the Commission's formulation of multi-line business customer PICCs and the increase in tandem switching and transport costs. Similar claims were made by the Telecommunications Resellers Association and other small IXC's that filed comments. These petitioners point out that the restructuring will have a disproportionate effect on these carriers because their businesses tend to specialize in small and medium business customers that do not have high toll usage. Further, because these carriers are small, they tend to purchase tandem-switched transport services from the LECs. The increases in tandem switching rates authorized by the Commission's *Access Reform Order* and the elimination of the "unitary" tariff for tandem-switched transport combine to raise significantly the access costs of these carriers.

The Commission should consider whether the changes to access pricing could have the "devastating" effect on resellers and small IXC's predicted by these petitioners. Today's long distance market offers consumers many choices for service partly because there are so many small interexchange carriers operating in regional and national markets. In recent years small IXC's (both "presubscribed" and "dial-around" companies) have gained a progressively larger

share of the interexchange market. This increased competition is good for consumers and good for competition in the interexchange industry. Further, the growth and success of these companies is good for the future of local exchange competition. Many of these companies are likely to become competitors in the local exchange, bundling together resold local and toll services.

The Commission's job is to promote competition, not protect competitors. But to have healthy competition, there must be healthy competitors. It is reasonable that the Commission consider the impact that its decision will have on these small IXCs and resellers that have built their businesses based on an access charge rate regime that has existed for many years. It is also fair to say that the effect identified by CompTel and others in their petitions was not fully understood during the process leading up to the Commission's decision in this case and that it is important that the Commission examine this issue now.

CompTel and ACTA each recommend that the PICC for multi-line businesses be set at the same level as the PICC for primary residential lines, set at \$0.57 per line initially, and that the reduction in access revenues be made up by an increase in the per-minute access charge.<sup>3</sup> Over time, the multi-line business PICC would increase in tandem with the residential PICC and the per-minute access rate would be reduced as access costs fall and the PICC rate changes.

---

<sup>3</sup>CPI notes that, under this scenario, the Commission should also set non-primary residential PICCs at the same level as multi-line business and primary line residential PICCs. Although no petitioner has proposed doing so, CPI would oppose an increase in the primary residential line PICC to recover a portion of the reduced revenue.



If the Commission acts to ameliorate the effects of multi-line business PICCs created in its *Access Reform Order*, there will be a difference in access revenue collected by the LECs. There are at least two ways in which the Commission can adjust its decisions to account for this change in access revenues. First, as the petitioners suggest, the Commission can raise the per-minute access charge rate to recover the revenue that would otherwise be collected by a multi-line PICC allowed to be priced at \$2.75 per line. Since the multi-line business PICC is the first of the new flat rate access elements scheduled to be reduced as access costs fall, this strategy essentially accelerates the reduction of the multi-line business PICC, while slowing down the removal of non-traffic sensitive costs from the per-minute access rate.

As mentioned previously, CPI supports the movement away from the collection of non-traffic sensitive (NTS) costs through traffic sensitive rates. In our comments in the Access Charge Reform case we offered several suggestions for rate structures that would collect various portions of the NTS revenue requirement in flat charges. However, CPI also advocated that the Commission begin moving access rates closer to economic costs by making meaningful reductions in the total access revenues collected by the LECs. The fact that the Commission ordered a modest reduction in access charges in its *Price Cap Performance Review Order* has contributed to the need for PICCs at their current levels. This consideration gives rise to the second (and preferred) option that the Commission should consider if it reduces the level of the multi-line business PICC.

The Commission should revisit the *Price Cap Performance Review Order* and consider whether

the difference in revenues created by reducing the multi-line PICC as suggested by the petitioners should be included in a larger "prescriptive" reduction in access revenues at the beginning of this process of access reform. CPI had advocated that the Commission adopt a prescriptive reduction -- a down payment on access charge reform -- of approximately \$2 billion. In an *ex parte* presentation to the Commission made on May 5, 1997, CPI offered three recommendations for how access charge reductions of at least \$2 billion could be accomplished.

The Commission's *Price Cap Performance Review Order* required access reductions of only about \$750 million beyond price cap reductions that would have occurred on July 1 anyway. CPI believes that additional access reductions (used to offset changes to the multi-line business PICC) would be within the \$2 billion reduction we advocated previously. CPI has attached a copy of its May 5, 1997 *ex parte* presentation as Attachment A.

Some of the petitioners request that the Commission permit LECs to continue offering end-to-end "unitary" tandem-switched transport services. The petitioners point out that this tariff scheme has the support (or non-opposition) of the entire industry and that retention of the "unitary" rate tariff would serve both the small IXC's as well as rural customers that receive service through such arrangements. Finally, the petitioners seek reconsideration of the Commission's decision to shift a large portion of the tandem revenue requirement to the tandem switching element. CompTel estimates that this change will increase tandem switching rates by approximately 400%.

Concerning the issues of tandem switching prices, the Commission's *Access Reform Order* is dealing largely with the collection of non-economic costs. (The increase in tandem switching rates derives largely from the shift of embedded costs collected previously in the Transport Interconnection Charge.) In this case, there is no "right" answer for the pricing of these elements that makes perfect economic sense. If the new rates for tandem switching greatly exceed long run incremental costs, as CompTel asserts, then the Commission must make its decision not entirely on the basis of economic costs, but also should consider the effect of pushing the collection of these non-economic costs onto the switching element. It is appropriate for the Commission to consider the effect that such higher switching costs will have on the rates and competitive choices of rural customers.

## **II. The Commission Should Grant AT&T's Request for Partial Reconsideration of the *Price Cap Performance Review Order*.**

CPI supports the petition of AT&T for partial reconsideration of the Commission's *Price Cap Performance Review Order*.<sup>4</sup> AT&T requests that the Commission reconsider three issues:

1) whether the price cap X-factor should be based on interstate-only data, instead of total company data; 2) whether the Commission should retain the "low end adjustment" in the price cap rules; and 3) whether the Commission should require the LECs to revise their price cap indices to levels that would have been in effect in 1995 using the permanent X-factor.

---

<sup>4</sup>See Petition of AT&T Corp. for Partial Reconsideration of the Commission's X-Factor Order.

CPI supports AT&T's petition as appropriate changes to the price cap formula that the Commission should adopt. First, CPI agrees with the analysis that, by failing to focus its X-factor analysis on the interstate activities of the price cap LECs, it is likely that the Commission has understated the X-factor. When computing the productivity potential of the LECs to produce interstate access services, the Commission should base its analysis on the interstate services provided by the LECs, not on the basis of their total company products. Second, we agree that the application of a revised X-factor to 1995 would be consistent with the Commission's decision to replace the interim X-factor with a permanent version and apply the revised factor to 1996. The application of the 6.5% X-factor for the entire period under review balances the equities between the access providers and their consumers. CPI believes that the Commission would have been on solid legal and theoretic ground if it had required the LECs to significantly reduce access rates to economic cost levels. The recommendation of AT&T to apply the revised X-factor to the entire period in which the interim price cap formula was in place should be adopted by the Commission.

We also agree that the Commission should reconsider its decision to retain the "low end adjustment" in the price cap formula, at least for large LECs. In its *Price Cap Performance Review Order*, the Commission revised the price cap plan to eliminate the "sharing" options under which a portion of earnings in excess of a benchmark would be shared between LECs and the purchasers of access services. The sharing mechanism provided a partial "backstop" against excessive earnings if the Commission's productivity offset (X-factor) were set too low. The sharing mechanism also served to divide the benefits of extra productivity gains between

producers and consumers.

The Commission described the elimination of sharing as the desirable eradication of the last vestiges of rate-of-return regulation for the price cap LECs. In its Order, the Commission noted that the sharing formula blunted the incentives provided by price caps. At the same time, the Commission retained the "low end adjustment" under which price cap LECs are permitted to raise the price of services if the earned return falls below 10.25%. But this adjustment provides a "backstop" on the downside for price cap LECs. In the same way that the sharing mechanism could be criticized as dulling price cap incentives and for being a vestige of rate-of-return regulation, the low end adjustment deserves the same criticisms. By eliminating sharing while retaining the automatic protection of the low end adjustment, the Commission has made the price cap bargain asymmetric. The Commission should make its decision consistent on these issues and eliminate the low end adjustment, at least for the largest price cap LECs.

### **III. The Commission Should Reject the Petition of USTA to Permit LECs to Delay Rate Reductions to Reflect Receipt of Universal Service Support.**

In its *Access Reform Order* the Commission requires the non-rural LECs to account for any support revenues that derive from the new federal universal service mechanism by reducing or satisfying the interstate revenue requirement otherwise collected through interstate access charges. In its Petition for Reconsideration and/or Clarification, the United States Telephone Association (USTA) recommends that non-rural LECs be permitted to reduce interstate access charges after 1998 by an amount equal to the interstate support received from the new federal

fund *less* the amount of high cost support received as of December 31, 1998. USTA recommends that this procedure be permitted for a period not to exceed five years and asserts that such a procedure will be necessary to protect universal service.<sup>5</sup>

In its petition, USTA asserts that the LECs will experience a revenue shortfall beginning on January 1, 1999 when the new federal high cost fund becomes operational. The implication of the USTA petition is that states may not permit full recovery of intrastate loop costs (currently about 75% of unseparated loop costs) and that interstate access charges should be kept artificially high to ensure that the LECs do not lose any revenues on January 1, 1999. Thus, in the name of "universal service", USTA suggests that the LECs should be able to retain a portion of the federal high cost support and not use the subsidy to reduce the prices of services.

USTA is essentially suggesting that non-rural LECs should be able to maintain excessive interstate access rates by not counting all the revenues that will derive from the federal high cost fund toward their federal revenue requirement. There are three reasons why the Commission should decline to adopt the recommendation of USTA. First, there is no certainty that the actions of states, combined with the effect of the new federal high cost fund, will result in any diminution of revenues to the LEC. USTA's concern is premature and the degree of any such revenue loss is speculative. Second, even if some LECs' revenues are reduced, the issue will be a state revenue issue, not a federal matter. LECs may seek increased revenues in state

---

<sup>5</sup>See USTA Petition for Reconsideration and/or Clarification at 10.

commissions if they are deserved; it is not necessary for the FCC to raise access rates to solve the issue. Third, because of the momentum of historic earnings, CPI believes that most price cap LECs will be earning above-market returns in the federal jurisdiction (and in many state jurisdictions) in 1999. Guaranteeing that such earnings are increased even further by a decision in mid-1997 to allow LECs to retain a portion of the federal subsidy simply cannot be justified under any public policy rationale.

**IV. The Commission Should Deny Petitions to Reconsider Its Decision to Exempt Prices for Unbundled Network Elements from Access Charges.**

The Commission has received petitions from some rural LECs asking the Commission to reconsider its decision to exempt the prices of unbundled network elements from access charges.<sup>6</sup> The Commission should deny those petitions.

The Commission's decision in CC Docket No. 96-98 (*Local Competition Order*) determined that the appropriate cost standard for UNEs was forward looking economic costs as measured by Total Element Long Run Incremental Costs (TELRIC). That decision recognized that TELRIC prices fully compensate incumbent local exchange companies for the cost of providing unbundled network elements, including the full cost of the loop. Although the pricing rules adopted by the Commission have been vacated by the Eighth Circuit Court of Appeals, the vast majority of States have proceeded to endorse the same pricing policy, recognizing how critical

---

<sup>6</sup>See Petition for Reconsideration of The Rural Telephone Companies and the Petition for Reconsideration of the Rural Telephone Coalition.

---

these correct prices are to the development of competition.

In its *Local Competition Order* and *Access Reform Order*, the Commission correctly found that competitors to local exchange companies that enter the market using purchased UNEs may provide any telecommunications services supported by those facilities, including the completion of long distance telephone calls made by or received by the local customer being served over the facilities. In other words, local competitors to the incumbent LECs can provide access services using the UNEs that have been fully paid for. The Commission reasoned, correctly, that it would be inappropriate to impose additional "access" costs on these elements when they were used to provide exchange access service.

By making UNEs available at economic costs and by permitting these paid-for facilities to be used for all telecommunications services, the Commission has acted in concert with the pro-competitive thrust of the Telecommunications Act of 1996. The Petitioners' position, that access charges should continue to apply to UNEs represents a "second bite" at the TELRIC pricing issue. The Commission should not agree to a request to unravel the Commission's (and the States') policies designed to enable and encourage competition in exchange access service and local exchange service.

Nor should the Commission be moved by the arguments that the exemption of UNEs from access charges means that incumbent LECs will not have the opportunity to recover the associated embedded costs. The question of whether, and in what manner, LECs should be able to recover



differences between historic costs and economic costs can be examined by the Commission and the States without overturning the pro-competitive and pro-consumer decisions adopted in the *Access Reform Order*.

**V. The Commission Should Deny AT&T's Request That the Commission Adopt a Mandatory End User Surcharge to Recover Universal Service Support**

CPI opposes the request of AT&T that the Commission require carriers to collect contributions to the Universal Service Fund through a monthly end user charge.<sup>7</sup> The Telecommunications Act of 1996 requires that all telecommunications *providers* contribute to the cost of universal service. Universal service supported through end user charges would contradict this requirement. The exact manner in which telecommunications providers re-collect the contribution should be subjected to competition in the marketplace. An end user surcharge defeats this mechanism and restricts the flexibility of the carriers to recover universal service costs. The Commission was correct not to adopt increased end user charges to fund universal service and should not modify its decision in this regard.

---

<sup>7</sup>See Petition for Reconsideration and Clarification of AT&T Corp. at 2.

## **VI. CONCLUSION**

CPI appreciates the opportunity to present its partial support and partial opposition to various Petitions for Reconsideration filed by several parties to these dockets. We respectfully request that the Commission modify its orders as recommended in this response to the motions for reconsideration.

Respectfully Submitted,

  
\_\_\_\_\_  
Competition Policy Institute

Ronald Binz, President and Policy Director  
Debra Berlyn, Executive Director  
John Windhausen, Jr., General Counsel

Competition Policy Institute  
1156 15th St. N.W. Suite 310  
Washington, D.C. 20005  
Phone: (202) 835-0202  
Fax: (202) 835-1132

---

## **Appendix A**

---

# CPI Competition Policy Institute

---

May 5, 1997

Chairman Reed E. Hundt  
Commissioner James H. Quello  
Commissioner Rachelle B. Chong  
Commissioner Susan Ness

Dear Mr. Chairman and Commissioners:

The Competition Policy Institute (CPI) urges the Commission to include access charge reductions in its upcoming orders on access charge reform and universal service. In our comments in this docket, we described the need for the Commission to make a "down payment" on access charge reform by *lowering* the amount local exchange carriers are allowed to collect for access services, in addition to restructuring access rates. While "market-based" pressures should reduce access charges over time, the Commission should begin the process with a prescribed reduction.

The purpose of this presentation is to illustrate how access charge reductions of \$2.25 billion can be achieved and incorporated in the Commission's upcoming decision in these matters. We offer three options for reducing the amounts collected for access services and illustrate the effect of each option on the eight largest price cap local exchange carriers.

The three options we recommend below are methods to reduce the amount of revenues the local exchange carriers will collect for access services, independent of how they are collected and independent of the specific details of a plan for universal service support. In other words, **these options may be incorporated into any other proposal for universal service support and access restructuring.** Reducing access revenues in one of the ways we suggest will result in lower revenues to be collected in whatever manner the Commission determines, through increased second-line SLCs, multi-line business charges, long distance rates or other charges. We believe that **CPI's options can be incorporated into Chairman Hundt's proposal for access charge reform:** they simply decrease the revenues that must be collected on top of the per-minute, traffic-sensitive access charges.

- Option 1: Reduce access revenues by lowering access revenues of each LEC by a uniform percentage.
- Option 2: Reduce access revenues by *partially* reinitializing price cap rates and *partially* reducing the revenues currently collected from the Transport Interconnection Charge (TIC).
- Option 3: Reduce access revenues by *partially* reinitializing price cap rates, *partially* reducing the TIC revenues and increasing the price cap X-factor.

Here is a description of each of these options; the attached spreadsheets and graphs demonstrate how the reductions work and the relative effect of each option on the eight largest LECs.

**Option 1: Reduce access revenues by lowering access revenues of each LEC by a uniform percentage.**

While there is debate about *exactly* how much access charges currently exceed economic costs, there is no debate that they are far in excess of such costs. This means that the Commission can reduce access charges across all LECs by a uniform percentage without running the risk of lowering them too much; i.e., without lowering them below economic cost. Since access charges eventually will move much lower when competition disciplines the access market, an initial move in that direction is justified as an appropriate policy leading toward that result.

Based on estimated 1997 LEC access revenues, a reduction of 10.76% will achieve a cumulative reduction of \$2.25 billion among the eight largest LECs. Attachment 1 illustrates the effect on each LEC of such a uniform reduction in access revenues.

**Option 2: Reduce access revenues by *partially* reinitializing price cap rates and *partially* reducing the Transport Interconnection Charge (TIC) revenues.**

Bell Atlantic, NYNEX and AT&T recommended that the Commission utilize a "triple play" formula to achieve access reductions for each price cap LEC. Some parties observed that this method produces somewhat uneven reductions among the various LECs, depending on how successful the carriers had been under price cap regulation.

CPI's Option 2 is an improvement on this "triple play;" here the reduction is spread more evenly among the LECs. Under this formula, the total access reduction is obtained by adding together i) reductions from *partially* reinitializing price cap rates and ii) reductions from eliminating a percentage of the TIC revenues.

Option 2 illustrates the method by reinitializing rates by 50% of the price cap earnings in excess of 11.25% and eliminating half the TIC revenues. This combination produces a reduction of \$2.26 billion. Attachment 2 shows the effect of this method on the eight largest price cap LECs. (The percentages can be varied so other combinations of these partial reductions are possible.)

**Option 3: Reduce access revenues by *partially* reinitializing price cap rates, *partially* reducing the TIC revenues and increasing the price cap X-factor.**

A third method to achieve access charge reductions is to incorporate a change in the price cap X-factor along with partial reinitialization and partial elimination of the TIC revenues. This method makes it possible to reduce further the reliance on reinitialization while producing a result

that is more nearly even across the LECs.

Under CPI's Option 3, the total access reduction is obtained by adding together i) reductions from *partially* reinitializing price cap rates; ii) reductions from eliminating a portion of the TIC revenues; and iii) reductions from increasing the price cap X-factor.

Attachment 3 illustrates this method with specific percentages that produce an access reduction of \$2.26 billion. In this example, price cap rates are reinitialized by one-third of the earnings in excess of 11.25%, the TIC is reduced by 44%, and the X-factor is increased from 5.3% to 7.5%. (Again, the percentages can be varied to obtain other combinations.)

### **Advantages of CPI's Options**

There are several advantages to using one of the three options recommended here:

- Any of these options can be incorporated into Chairman Hundt's access reform proposal, as we understand it. Other access restructuring (e.g., shifting per-minute revenues to flat charges) can proceed with lower total revenues being recovered.
- By relying only partly on price cap reinitialization, these proposals avoid the criticism that they are unfair to certain price cap LECs or remove too much of the price cap incentives.
- These options spread the access reductions more evenly among LECs than other methods. Option 1 reduces access revenues by the same percentage for all LECs; Options 2 and 3 base reductions on several factors, but the reductions are greatest for the largest LECs.
- These options produce a reasonable "down payment" on access reform of \$2.25 billion. Since access charges are currently far above economic costs, a reduction of this size (about 10.8%) is a moderate initial movement toward cost-based access charges.

We hope these ideas are useful to the Commission and welcome the opportunity to provide any additional detail the Commission desires.

Sincerely,



COMPETITION POLICY INSTITUTE

Ronald J. Binz, President

Debra R. Berlyn, Executive Director

John Windhausen, Jr., General Counsel

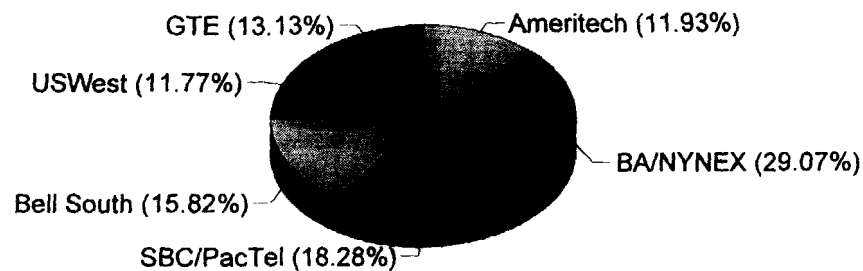
**Competition Policy Institute**  
**Access Reduction Down Payment — OPTION 1**

**OPTION 1**  
**Access Charge Reduction Formula**

*For each LEC, total access charge reduction is a percentage decrease in access revenues.*

Percentage access revenue reduction	10.76%
Total Reduction (billions)	\$2.250

**Shares of Access Reduction**  
**Option 1**



	1996 ROI	7/1/97 Acc Rev	Reduction of 10.76%	Total Reduction	Reduction as % of Rev	LEC Share of Total Reduction
Ameritech	18.27%	2495	268	268	10.76%	11.93%
Bell Atlantic	11.31%	2907	313	313	10.76%	13.90%
Bell South	16.24%	3308	356	356	10.76%	15.82%
NYNEX	13.87%	3171	341	341	10.76%	15.16%
Pacific Telesis	17.91%	1754	189	189	10.76%	8.39%
SBC	11.80%	2068	223	223	10.76%	9.89%
USWest	13.57%	2461	265	265	10.76%	11.77%
GTE	17.62%	2746	295	295	10.76%	13.13%
Total		20910	2250	2250	10.76%	100.00%
BA/NYNEX		6078	654	654	10.76%	29.07%
SBC/PacTel		3822	411	411	10.76%	18.28%

Note: Data obtained from BA/NYNEX ex parte presentation of AT&T/BA/NYNEX proposal.

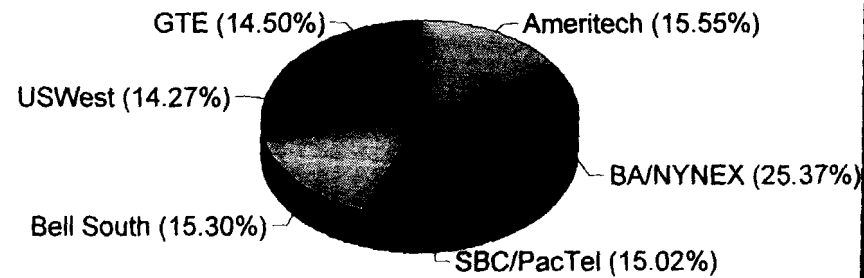
**Competition Policy Institute**  
**Access Reduction Down Payment — OPTION 2**

**OPTION 2**  
**Access Charge Reduction Formula**

*For each LEC, total access charge reduction is a percentage reduction of earnings in excess of 11.25% plus a percentage reduction in the TIC.*

Percent Sharing of Excess Earnings	50.00%
Percent Reduction in TIC	50.00%
Total Reduction (billions)	\$2.263

**Shares of Access Reduction**  
**Option 2**



	1996 ROI	7/1/97 Acc Rev	Earnings over 11.25%	7/1/97 TIC	Sharing Reduction	TIC Reduction	Total Reduction	Reduction as % of Rev	LEC Share of Total Reduction
Ameritech	18.27%	2495	363	341	181	171	352	14.11%	15.55%
Bell Atlantic	11.31%	2907	5	334	2	167	169	5.83%	7.48%
Bell South	16.24%	3308	404	289	202	145	346	10.47%	15.30%
NYNEX	13.87%	3171	156	654	78	327	405	12.76%	17.88%
Pacific Telesis	17.91%	1754	281	137	140	68	209	11.90%	9.23%
SBC	11.80%	2068	20	242	10	121	131	6.34%	5.79%
USWest	13.57%	2461	152	494	76	247	323	13.12%	14.27%
GTE	17.62%	2746	462	195	231	97	328	11.95%	14.50%
Total		20910	1841	2685	921	1343	2263	10.82%	100.00%
BA/NYNEX		6078	160	988	80	494	574	9.45%	25.37%
SBC/PacTel		3822	301	379	151	189	340	8.89%	15.02%

Note: Data obtained from BA/NYNEX ex parte presentation of AT&T/BA/NYNEX proposal.



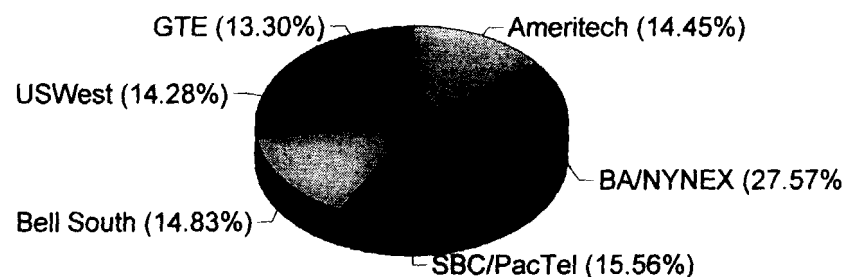
**Competition Policy Institute**  
**Access Reduction Down Payment — OPTION 3**

**Access Charge Reduction Formula**

*For each LEC, total access charge reduction is a percentage reduction of earnings in excess of 11.25% plus a percentage reduction in the TIC, plus the effect increasing the price cap X-factor.*

Percent Sharing of Excess Earnings	33.33%
Percent Reduction in TIC	44.00%
Increase X-factor from 5.3% to:	7.50%
Total Reduction (billions)	\$2.255

**Shares of Access Reduction  
Option 3**



	1996 ROI	7/1/97 Acc Rev	Earnings over 11.25%	7/1/97 TIC	Sharing Reduction	TIC Reduction	X-factor Reduction	Total Reduction	Reduction as % of Rev	LEC Share of Reduction
Ameritech	18.27%	2495	363	341	121	150	55	326	13.06%	14.45%
Bell Atlantic	11.31%	2907	5	334	2	147	64	213	7.31%	9.42%
Bell South	16.24%	3308	404	289	135	127	73	335	10.11%	14.83%
NYNEX	13.87%	3171	156	654	52	288	70	409	12.91%	18.15%
Pacific Telesis	17.91%	1754	281	137	94	60	39	192	10.97%	8.53%
SBC	11.80%	2068	20	242	7	106	45	159	7.67%	7.04%
USWest	13.57%	2461	152	494	51	217	54	322	13.09%	14.28%
GTE	17.62%	2746	462	195	154	86	60	300	10.92%	13.30%
Total		20910	1841	2685	614	1182	460	2255	10.79%	100.00%
BA/NYNEX		6078	160	988	53	435	134	622	10.23%	27.57%
SBC/PacTel		3822	301	379	100	167	84	351	9.18%	15.56%

Note: Data obtained from BA/NYNEX ex parte presentation of AT&T/BA/NYNEX proposal.